How Inflation Hits the Majority

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How Inflation Hits the Majority

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The rate of inflation in the basic necessities—food, energy, housing, and health care—outstrips the general inflation rate, hitting the broad middle range of the population especially hard.

Since inflation is probably the most urgent economic—and political—issue in the United States today, it is important to determine whom it hits hardest, in what way they are affected, and how successful current administration policy is in dealing with the problem. The group to be considered here is the broad middle range of the income distribution, that is, all but the upper 20 percent, or very affluent, and the bottom 10 percent, or very poor. Thus, we are dealing with the great majority of the population. They are present, future, or former wage and salary earners. The income they receive from wages and salaries, or from transfer payments related to these earnings (social security and unemployment compensation) accounts for more than 75 percent of the financial resources available to them, excluding debt (Table 1). They differ from the bottom 10 percent in that their income is generally sufficient to disqualify them from public subsidies such as food stamps or rent allowances that offer some marginal protection from the "new" inflation. They differ from the top 20 percent in that their "portfolios" of income-producing assets are much less diverse. The protective devices of hedging, arbitrage, tax shelters, capital gains, superior interest rates paid on large denomination commercial paper, certificates of deposit, or government securities and self-determined professional fees are largely unavailable to them. For the sake of convenience, they

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Table 1

Sources of Income—All Urban and Rural Families and Single Consumers

Family income before taxes—complete reporting of income (income deciles)

	Total (complete reporting)	Lowest 10%	2nd 10%	3rd 10%	4th 10%	5th 10%	6th 10%	7th 10%	8th 10%	9th 10%	Highest 10%
Percentage shares of total money income:											
Wages and salaries, total	74.9%	21.0%	28.6%	46.1%	63.2%	73.0%	80.4%	82.9%	84.9%	86.4%	72.6%
Self-employment income, total	7.6	1.1	3.6	5.0	5.7	5.8	5.3	5.0	4.9	4.4	14.7
Social security and railroad retirement	4.9	45.5	36.0	22.9	11.3	6.3	3.6	2.4	1.8	1.0	0.9
Government retirement, veteran's payments, and unemployment compensation	2.5	4.7	5.9	5.6	4.7	4.0	2.4	2.3	1.7	1.9	1.4
Estates, trusts, dividends, rental income royalties, income from roomers and boarders, total	4.6	4.7	6.5	6.7	5.4	4.7	3.3	2.8	2.9	2.9	7.0
Income from all other sources, total (welfare and public assistance, private pensions, regular contributions for support, other income, including workers' compensation)	2.9	40.1	20.9	13.1	7.8	5.8	5.1	4.2	3.7	5.1	0.7

Source: Bureau of Labor Statistics, *Consumer Expenditure Survey 1972-73*, Bulletin 1992, Table 6.

can be called "the working class."

Despite the popularization of the image of the "affluent worker," most working class families are among the 70 percent of the population most vulnerable to the new inflation, characterized as it is by disproportionately high rates of inflation in the four basic necessities—food, energy, shelter, and health care (see Table 2). It has often been pointed out that "the poor" are hurt most by inflation, because such a large proportion of their meager disposable incomes must be devoted to the consumption of necessities. But it has not been as clearly understood that an additional 70 percent of the population are hurt almost as much for the same reason.

Importance of Consumer Expenditure Survey

The latest Consumer Expenditure Survey was conducted in 1972-73 (before the recent acceleration of inflation, especially in the basic necessities). An analysis of the data in this survey indicates that

Table 2

Occupation of Family Head and Average Family Income, July 1973 through June 1974

Occupation of family head	Number of families reporting	Percent of total reporting	Average family income	Decile equivalent
Craftsmen & operatives	17,068	26.1%	$11,201	6th
Clerical & sales workers	7,917	12.1	10,524	5th-6th
Laborers & service workers	8,366	12.8	8,049	4th-5th
Retirees	11,934	18.3	4,646	2nd-3rd
Self-employed	5,357	8.2	12,298	6th-7th
Armed forces personnel	720	1.1	12,215	6th-7th
Professionals and managers	13,928	21.3	15,510	7th-8th
Total	65,290	100.0	10,524	5th-6th

Source: Bureau of Labor Statistics, *Consumer Expenditure Survey, Diary Survey 1973*, Report 448-2, Table 6.

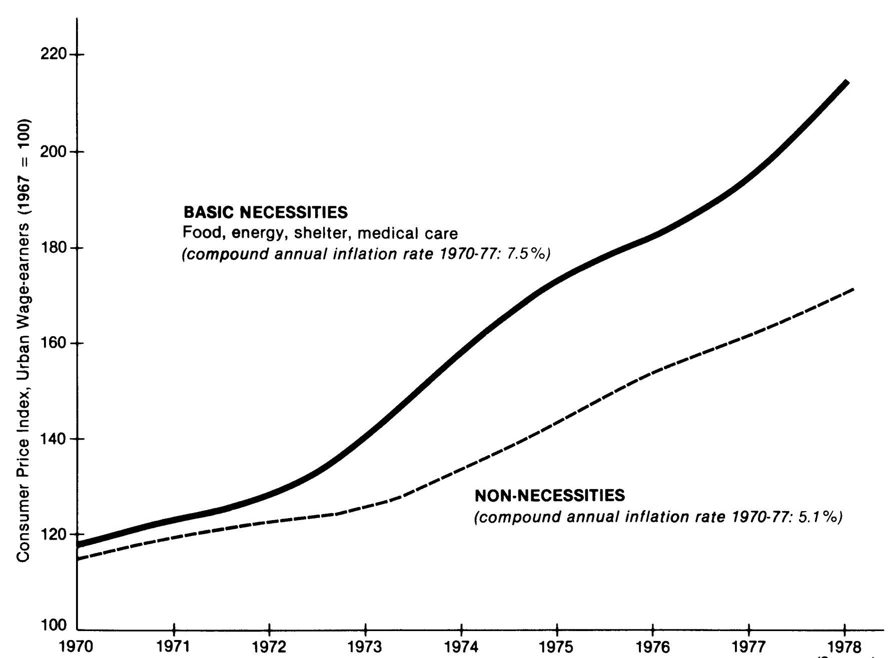
for the broad middle range of the income distribution, expenditures on food, energy, shelter, and health care account for roughly 70 percent of the household consumption budget. At the upper end of this income range, the necessities were found to constitute about half the consumption budget. But at the bottom of the range, they constituted more than the entire budget, because of families' going into debt or falling behind in bill payments in order to provide themselves with the four basic necessities. Payment for the four necessities is predominantly nonpostponable, and about 30 percent of such payments are billed to households monthly by utility companies, insurance carriers, landlords, and financial institutions.

When the price increases for each of the necessities are combined, using the relative importance factors of the Bureau of Labor Statistics as weights, a "necessities price index" can be created. A look at the chart will show that inflation in the necessities has been substantially greater than that for the non-necessities.

Between 1970 and 1977 the annual rate of inflation for the four basic necessities was nearly half again as high as the annual inflation rate for the non-necessities (7.5 percent vs. 5.1 percent), widening the gap between the two. With 1967 as the base year, the necessities index in 1970 was only 3.5 percent higher than the non-necessities index. *In 1977, on average, it was 21 percent higher.* Over the past six months the gap has continued to widen: as of September, 1978, necessities prices were increasing at an average annual rate (11.6 percent) more than double that of non-necessities (5.7 percent).

By looking at inflation in this manner, which reflects more accurately the way ordinary people experience it, one realizes that counter-inflation programs that focus on budget cuts, dampening wage increases, or attempts to curb the growth of the money supply by raising interest rates have virtually no effect on those sectors that exert the most painful pressure on real living standards. These conventional economic procedures were devised to deal with inflation that resulted either from the push of rising wage costs or the pull of excess demand. But our new inflation is derived from neither of these. Rather, each of the necessity sectors is characterized by major structural problems of its own on the supply side that will be largely immune to the orthodox policy nostrums. In fact, the use of ordinary tools of economic policy may even compound the misery of inflation in the necessities.

Comparative Inflation Rates:
Necessities and Non-Necessities



Causes of inflation in necessities

Recent energy price inflation has no basis whatsoever in wage-cost push; energy-supply industries are among the most capital-intensive in our economy. The original jolt to energy prices came out of the OPEC cartel decision. Since then, oil prices have continued to rise as higher-priced foreign oil has claimed a larger and larger share of domestic consumption. Prices of other energy sources have moved up in tandem, supported by the oil companies' acquisition of additional sources of energy. Major manufacturing corporations have also established a resource position for themselves by acquiring mining firms. All of this activity enhances the ability of these corporations to sustain profit margins through price increases regardless of the state of demand. Thus the basic organization of supply, coupled with the dismantling of the public presence in price policy through natural gas deregulation, assures continuing inflation in this sector. The orthodox economics tool box has nothing in it to deal with these problems.

And because our economic infrastructure—our choice of industrial processes, suburban sprawl, shopping centers, all-glass office buildings, etc.—has been predicated on the existence of plentiful, relatively cheap energy, energy inflation feeds directly into the costs of virtually all goods and services that comprise our economy, making inflation in this sector especially pernicious, over and above its impact on household consumption budgets.

The pressure of energy inflation has been especially strong on food costs, largely because of the energy-intensive nature of our methods of agricultural production and distribution. Food inflation has also been sustained by increased farm price supports and supply curtailments supported by both Congress and the administration. But there are deeper underlying reasons for persistent food price inflation: the trend, since World War II, toward rapid growth in world demand stemming from rising incomes and population overseas; the increasing number of intermediary stages between consumption and production; and the growing dominance of agribusiness corporations such as Beatrice Foods, Iowa Beef Processors, and Tenneco (many of them virtually unknown ten years ago). The first two factors render food prices more vulnerable to short-run shocks such as climatic conditions or large foreign grain sales, like the famous sale to the Soviet Union in 1972. The third enables well-placed vertically integrated corporations to create and extract profits from both consumers and primary producers.

As for housing, far and away the most inflationary components of the shelter price index have been financing, taxes, and insurance costs, none of which can be curbed with the standard macroeconomic tools. On the contrary, as the Federal Reserve Board raises interest rates to stanch speculation against the dollar or to limit the growth of the money supply, inflation in housing will be worsened. This occurs not only because of the flow-through effects on mortgage interest rates but because of the high degree of leveraging in the construction industry. Rising new home prices pull up the price of used homes. Inflated market values in turn generate rapid increases in property taxes for existing homeowners and push up rents.

With respect to medical care, in spite of its relatively labor-intensive character, wage-push is not responsible for the extraordinary inflation over the past seven to eight years. Martin Feldstein and Ann Taylor, in their article, "The Rapid Rise of Hospital Costs," point out that despite recent advances in hospital workers' pay, labor costs have actually been a declining fraction of total cost per patient day, even after the very rapid increase in physicians' fees (Council on Wage and Price Stability [COWPS], January 1977). Many analysts suggest that the basic reason for skyrocketing medical costs is hospital fees, which have risen dramatically since 1970. These in turn depend on the presence of third-party insurers. Since most insurance plans offer better coverage for hospital care than for physicians' services, people needing care are forced into the choice of high-cost services. Other factors contributing to inflated health care costs are excessive and expensive hospital construction, investment in little-used machinery, and the quasi-monopoly practices of doctors.

Interestingly enough, the Carter administration has perversely recognized the special character of these major components of our current inflation by exempting them in whole or in part from the guidelines program. Farm level food prices, energy "raw material" prices and internal transfer prices (those that one corporate affiliate charges another) are specifically exempted. Hospital costs are expected to decelerate by two percentage points below average charges for the past two years, but there is no mention of medical insurance premiums or professional fees. Interest rates are also outside the program. The omission of these major components of the "new inflation" illustrates that the drafters of the program have not confronted the inflation problem as it exists for the mass of the American people.

Effect on wages

Instead, the COWPS, while admitting that "excessive wage increases were not the *cause* of the current inflation" have determined that "wage moderation is an essential part of the *cure*" (their emphasis). Indeed, the very heavy lid placed on wages compounds the inflation problem as it is experienced by average income households.

The depressing effect of overall inflation on workers' take-home pay (not to mention fixed pension payments, unemployment compensation, etc.) is now fairly widely known. As of August 1978, average weekly earnings in real terms (1967 dollars) amounted to $103.74, lower than the 1971 annual average of $104.95. On an after (federal) tax basis, spendable weekly earnings were equally depressed ($92.41 for a married worker with three dependents in August 1978, compared to $92.67 annual average in 1971). Working class incomes have undoubtedly been squeezed even further by the rapid growth of state and local taxes, which tend to be more regressive than federal taxes. This helps explain the recent widespread support for tax cuts: people will grasp at any promise of even partial restoration of lost real income.

In this context, disproportionately high rates of inflation in the basic necessities add to the burden. Their impact can be highlighted by estimating what real earnings would have been had prices of the necessities increased at the same rate as the rest of the CPI. If this had been the case, average weekly earnings (before-tax) in real terms in August 1978 would have amounted to $120.67, nearly 16 percent higher than they actually were and 10 percent above their 1973 peak.

It has been argued that families have been able to recoup earnings lost to inflation by sending more family members into the work force, as illustrated by the dramatic increase in labor force participation rates of women and youth. This effort, however, has not been sufficient to offset inflation's toll. In 1977, median family income in constant (1977) dollars was lower than the 1972 median. On a pre-tax constant dollar basis the 1977 median was 2.5 percent below the previous peak (1973). Moreover, the $16,009 median (pre-tax) family income in 1977 was substantially below the $17,106 the Bureau of Labor Statistics estimates it cost an urban family of four to maintain a "moderate" living standard in autumn of that year.

As average income households are forced by "unequal" inflation to spend more and more just to purchase a stable level of necessities, one would expect to find a dampening of demand for those major categories of consumer durables and other types of discretionary expenditures that in fact have been the leading sectors in our recent economic recovery. But the demand has not declined. The reason is of course that discretionary spending has been sustained through a dramatic expansion of household debt. In 1977 consumer installment debt outstanding (excluding mortgage debt) reached the record level of 16.6 percent of personal disposable income. Between 1970 and 1976 this figure averaged 15.4 percent, peaking in the boom year 1973 at 16.2 percent. Although it is frequently argued that debtors benefit from inflation by repaying loans in deflated dollars, working class debtors cannot reap the full advantage of this effect. They commonly pay interest rates of 12 to 18 percent, far in excess of overall inflation and of the increase in their nominal earnings. For this reason, it is clear that ordinary households will be limited in how many more of these fixed commitments they can take on.

Response of the policy-makers

Recognizing this, public policy-makers seeking to avoid recession have to decide whether they are going to look for some source of demand other than household consumption expenditures to sustain economic growth, or whether they are going to rehabilitate the real income of the working class majority. The Carter guidelines program makes it quite clear that this administration has chosen the former course.

The guidelines program as it is known at the moment protects the comfortable profit margins that firms were able to sustain through the last two years of economic recovery, supported by rapid expansion of household debt. According to the regulations issued by the Council on Wage and Price Stability, in principle a firm can raise its prices by more than 9.5 percent and still technically be in compliance with the price standards if it can show "unavoidable cost increases" (say, energy costs the firm failed to offset through greater efficiency or internal transfer prices increased by another company division—the latter are specifically exempt). It need only show that its profit margin on sales is no higher than the average of the firm's best two out of three past years.

If firms take the administration at its word and assume that this program will continue for more than one year, it will make sense for them to maximize price and profit-margin increases through the many exemptions and loopholes available to them. If we assume that in the coming year prices will go up 8 percent and employee compensation (wages and fringes) will be held to a 7 percent increase, unit labor costs will rise 5.75 percent, if legislated payroll tax increases add .5 percent to the wage bill, and productivity goes up 1.75 percent as COWPS is assuming. If non-labor costs rise by the same percentage as labor costs, under the guidelines firms will be able to improve their price mark-ups by 2.25 percent, while workers' real compensation, and especially real disposable earnings, are falling.

The administration has shown some awareness of the problem of lowered real wages by proposing a federal income tax rebate optimistically called "real wage insurance." Unfortunately, there is no way of knowing what this scheme will look like after winding its way through Congress. But even under the best of circumstances, whatever compensation is offered will become available only after April 16, 1980. With employers enforcing wage guidelines beginning October 1978, workers will be making an 18-month interest-free loan to the government, while at the same time their real take-home pay is falling.

To the extent that inflation is a "problem" because it is eroding the real value of working class incomes, it is an issue that will persist under the guidelines program. The guidelines are finely crafted to sustain and advance the redistribution of real income from labor to capital, from people to corporations, but will provide no solution for inflation as it is experienced by the majority of the population. For the working class majority, solutions to inflation can only be found through major structural changes in the way our economy produces and distributes basic goods and services. Such a program would encompass the following: promotion of agricultural production near urban areas (thus facilitating more direct contact between producers and consumers), while curtailing the current trend toward expansion of production on marginal land; massive efforts directed toward conversion to solar energy; a national health care system; and a national housing policy coordinating environmental planning and public subsidies for low- and moderate-income housing. This is a path our present government is obviously unwilling to follow.

The Roots of Inflation

It remains true that there can be no inflation that is not validated by public policy. And that, consequently, it is faulty governmental policy that is, in a sense, "responsible" for all inflation. But if that statement is true, it is also vapid. The "government" is not a *deus ex machina*, "exogenous" to the economic process. It is part of the process, and its decisions are themselves molded by the private economic interests it is supposed to control. Every government expenditure, tax, and money transfer has, not only a macroeconomic, but a microeconomic consequence as well, and, even more important, an impact on the economic welfare of some group of private parties. The resistance of *aggregate* government taxes and expenditures to macroeconomic considerations, particularly to the requirements for controlling inflation, is explicable in precisely the same terms as the resistance of private price and wage policies. These individual governmental activities are part and parcel of the process by which income shares are determined. And when we attribute inflation to the actions by which private parties with economic power lay claim to the national product— in such a way that the sum total of those claims exceeds the capacity of the economy—we should obviously include among the methods for asserting those claims, not only the administration of wages and prices, but the exertion of influence over government outlays, taxes, tax preferences, and transfers. The government is not external to the process by which private power is exerted to produce inflation. It is part of that process.

The phenomenon of chronic inflation seems deeply rooted in the political and economic dynamics of a mature capitalistic society. It should not be surprising that it has gotten worse rather than better during 1973 and 1974, as the expansion of our aggregate productive capacity has begun to slow down. Peacetime inflation could become even more intractable than it has seemed to be so far if the expectations of perpetually rising standards of living now built into the American consciousness are doomed to progressive disappointment.

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